business of leasing unbundled network elements, which is the business for which the cost of capital is being determined.

Q. WHAT THEN, IS THE CORRECT APPROACH TO ESTIMATING THE COST OF CAPITAL THAT ACHIEVES THIS OBJECTIVE?

A. The correct approach is spelled out in detail in my prepared direct testimony. First, I selected a group of comparable, publicly traded, independent telephone companies from which to derive my data.[1] Second, I calculated the actual debt costs incurred by Verizon. Third, to estimate the cost of equity, I used both: (a) a three-stage discounted cash flow ("DCF") methodology based on the future dividends expected by investors in the comparable group of companies identified in step one; and (b) the capital asset pricing model ("CAPM") in which I calculated a "risk premium" for the comparable companies (based on their price volatility in relation to other stocks), which I then added to a risk free rate of return. Finally, using the debt cost calculated above, and the midpoint of the cost of equity calculated using the DCF and CAPM methods, I calculated a weighted average cost of capital based, alternatively, on **the telephone holding companies' average book capital structure and then on their market weighted capital structure (reflecting the market value of their stock)**.

[1] Currently, there are no "pure-play" companies operating exclusively as a wholesale provider of unbundled network elements. Indeed, there are few if any publicly-traded firms that provide only local telephone service. The most comparable companies are the large regional telephone holding companies ("RHC"s), which have been required to provide unbundled network elements at wholesale. If anything, because RHC's currently engage in more risky businesses of selling retail phone service, cellular service, paging, information services, long-distance, cable and the like, using these companies as comparables leads to cost of capital estimates that are necessarily conservative (i.e., too high).